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No. 74-339

IN THE

Supreme Court of the United States

October Term, 1974

PAT RYAN & ASSOCIATES, INC.,

Petitioner,

vs.

OCCIDENTAL LIFE INSURANCE COMPANY OF NORTH CAROLINA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

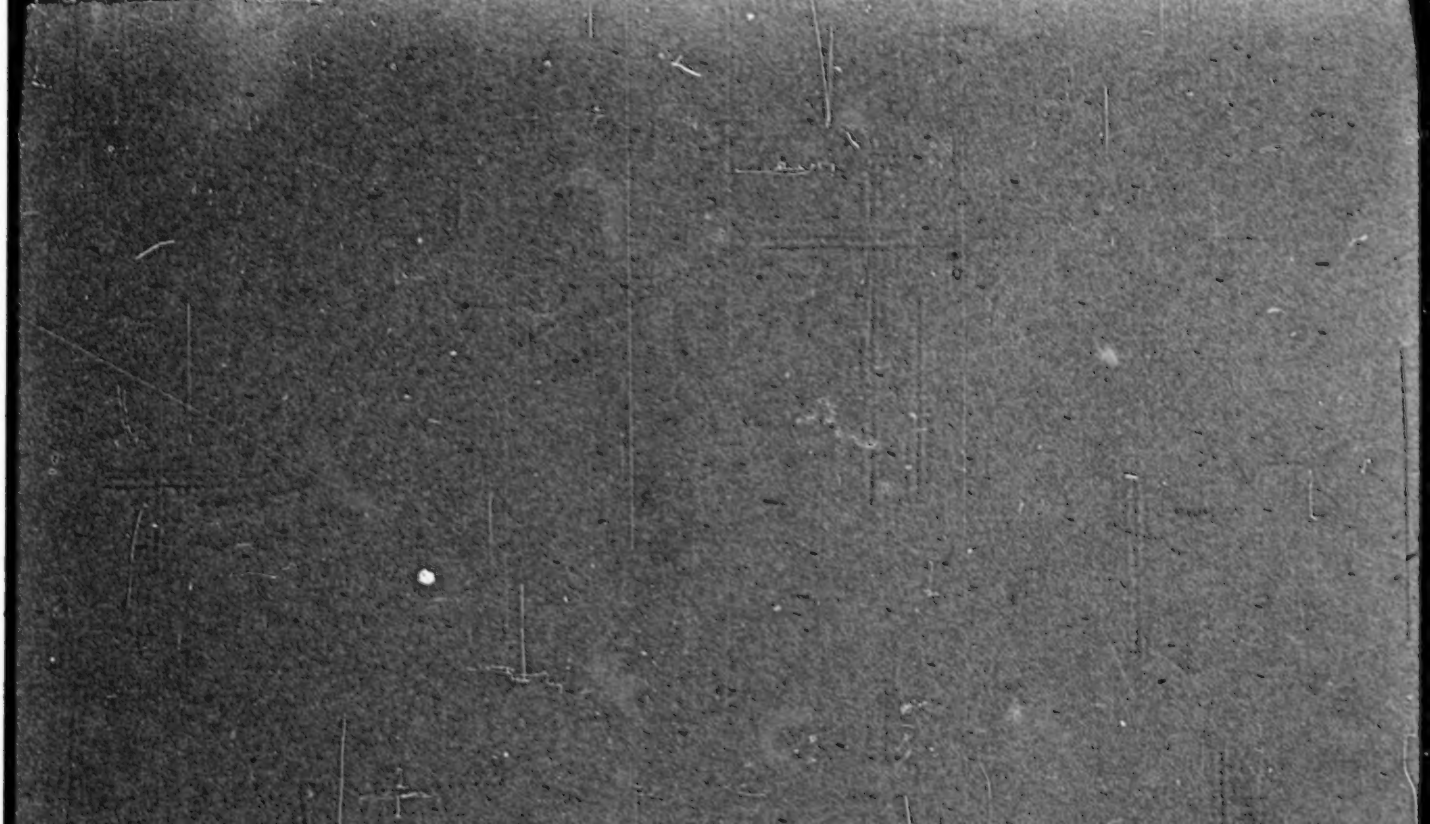
BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

RICHARD M. PHILLIPS
ALAN J. BERKELEY
GREGORY T. DIAZ
2000 L Street, N. W.
Washington, D. C. 20036
Counsel for Respondent

Of Counsel:

HILL, CHRISTOPHER AND PHILLIPS, P. C.
Washington, D. C. 20036

GEORGE R. RAGSDALE
Raleigh, North Carolina 27602



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BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent files this brief in opposition to a Petition for a Writ of Certiorari to review the judgment of the Court of Appeals for the Fourth Circuit, entered in this case on May 8, 1974. Rehearing was denied on June 24, 1974.

OPINIONS BELOW

The opinion of the Court of Appeals is officially reported at 496 F.2d 1255, and is printed at Pages 1a through 23a of Appendix A to the Petition. Appendix A to the Petition also includes the opinions of the District Court that accompany those of its orders that are pertinent to the Petition.

JURISDICTION

Respondent does not question the statement of jurisdiction as set forth in the Petition.

QUESTIONS PRESENTED

1. Whether the court below correctly held that a seller of securities found to have violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder may recover the unpaid purchase price where the buyer has retained the securities, waived rescission and has been fully compensated for damages causally related to the violation.

2. Whether the court below properly determined that the trial court did not abuse its discretion in setting aside a jury verdict as excessive where the jury did not follow the court's instructions and awarded damages that bore no rational relationship to the defendant's losses.

STATUTES AND REGULATION INVOLVED

In addition to the statutes and regulation printed in Appendix B to the Petition, the statutory provision involved is Section 28(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a) (1970). Section 28(a) provides in relevant part that

> ". . . no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of."

COUNTER-STATEMENT OF THE CASE

The Trial in this Case

Petitioner, Pat Ryan & Associates, Inc. ("Associates") seeks certiorari for a decision of the Court of Appeals for the

Fourth Circuit which refused to interfere with the discretion of the trial court in setting aside a jury verdict awarding damages in the amount of $797,000 and affirmed a judgment in the second trial awarding damages in the amount of $370,000. The verdict was rendered on a counterclaim in an action for breach of contract originally instituted against Petitioner in the state courts of North Carolina by Respondent, Occidental Life Insurance Company of North Carolina ("Occidental"). The action arose out of Petitioner's repudiation of an agreement to pay a balance owing of $770,000 for its purchase of Occidental's wholly-owned subsidiary, Virginia Surety Company, Inc. ("Virginia Surety").

Associate's counterclaim, filed after removal of the suit to federal court, initially alleged only claims of breach of warranty and common law fraud (Ans. and Counterclaim at 4-9, R. at 24).* But on November 3, 1972, nearly two years after it had filed its counterclaim, and only ten days prior to the date set for the trial, Associates moved for leave to amend its counterclaim. The amended counterclaim for the first time sought rescission and alleged that Occidental had violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970) ("Exchange Act") and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5, in connection with the sale of Virginia Surety.

The court below initially denied Associates leave to amend, but at the conclusion of the evidence submitted th amended counterclaim to the jury. That jury returned a verdict in favor of Associates and awarded damages in the amount of $797,000. The court, however, set aside the verdict, finding that "at least

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*Citations to the record below will appear as "Complaint [*e.g.*] at , R. at ." "R" refers to the page number at which the item is to be found in the Record on Appeal, as cited in the Index of Record on Appeal. Citations to the reporter's transcript of the first trial will appear as "Tr. I, 11/17/72 [*e.g.*] at ." (Reference to dates in the first transcript are necessary because each day's transcript of that trial is separately paginated). Citations to the reporter's transcript of the second trial will appear as "Tr. II at ." Citations to the Petition for a Writ of Certiorari will appear as "Pet. at " and citations to the Appendix included therein as "Pet. App. at ."

with respect to the issue of damages, [it] was so grossly contrary to the weight of the evidence as to be shocking to the conscience of the court." (Pet. App. at 26a). The court also found that "in view of the circumstances surrounding the filing of [Associates'] amended answer and counterclaim . . . justice requires that a new trial be had on all of the issues arising" on the counterclaim. (*Id.*). Accordingly, the court also set aside a verdict it had directed on Occidental's breach of co tract claim.

A second trial before a jury commenced on April 23, 1973, nearly three years after Occidental filed its original lawsuit. At the conclusion of the evidence in the second trial, the court again directed a verdict in favor of Occidental on its breach of contract claim. The jury entered a verdict in favor of Associates on its counterclaim, and awarded damages in the amount of $370,000.

The trial court found even in the second trial ". . . that . . . [the] evidence failed to establish convincingly that [Associates'] . . . damages exceeded the sum of $200,000." (Pet. App. at 31a). It nevertheless was "unable to say . . . that the jury's finding was wholly without evidentiary support or that it is so grossly excessive as to be shocking to the court's conscience." (*Id.*). It therefore denied Occidental's motion to set aside the jury's verdict.

The Sale of Virginia Surety

Virginia Surety was engaged in the business of writing long-haul trucking insurance. At the time of sale the company was licensed to conduct an insurance business in 49 of the 50 states and the District of Columbia. Pursuant to agreements between the parties dated October 22, 1969, Virginia Surety was sold to Associates as a "shell' corporation, without liabilities and without its agency plant or book of insurance business. The parties agreed that the only assets of Virginia Surety at the time of sale were to be its corporate charter, its insurance licenses in 50 jurisdictions, and its capital and surplus. The capital and surplus consisted of bonds on deposit with state insurance departments, which the parties expressly valued in the October 22 agreements at $1,326,717.70.

The sale was closed on October 30, 1969. At that time Associates took possession and control of Virginia Surety and has operated the company as its own continuously thereafter.

The agreements for the sale of Virginia Surety provided for a total consideration of $2,297,000. The agreements provided that Associates would pay Occidental $1,527,000 in cash on the closing date. Associates also agreed, as additional consideration for Virginia Surety, to furnish Occidental with a minimum of $770,000 over a period of three years in reinsurance premiums from insurance to be placed with Occidental and immediately reinsured by Occidental with other companies designated by Associates. Moreover, Associates specifically guaranteed that if, for any reason, it did not perform under the reinsurance agreement, it would pay Occidental $770,000 in cash over the three year period.

The October 22 agreements contained no representations or warranties with respect to Virginia Surety's licenses. Transfers of insurance companies and the licenses held by them are not routine. "[A]s is customary, States are always very concerned about who the buyers of the company are going to be and they will take various tacks to have an opportunity to approve the buyers." (Tr. II at 258). Moreover, since Associates proposed that it use Virginia Surety's licenses to write credit life, accident, health and liability insurance, lines of insurance which Virginia Surety was not authorized to write, Virginia Surety would be required to amend its licenses under the laws of various states. (Tr. II at 1267). It was for this reason that Associates was advised during the course of negotiations that Occidental would not warrant the status of the licenses held by Virginia Surety. "It is the sort of thing that you can't warrant, how a State is going to receive a new buyer . . . [A] company might want to change the purposes of it . . . , the backing of the company might be different, and a license could be cancelled, and these are things over which we would have no control." (Tr. II at 312).

After the closing of the October 22 agreements and the transfer to Associates of Virginia Surety, Associates failed to generate for Occidental any reinsurance premiums whatsoever

and refused to make any cash payment under its guarantee. (Tr. II at 161, 180). Accordingly, Occidental commenced this action on July 21, 1970, because "[t]here had been nothing put in the pipeline to pay us and it became increasingly apparent . . . that the fellow had no intention to pay us." (Tr. II at 330).

Associates' Counterclaim

Petitioner alleged in its amended counterclaim that Respondent's failure to disclose certain material facts violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Petitioner claimed that these facts caused Virginia Surety's license to be revoked in Connecticut and Maryland, as well as "licensing difficulties" in other states and damage to both the reputation of Virginia Surety and Associates. (App. at 14a-15a).

At trial, Petitioner's proof of license revocation or "difficulties" was limited to five states, Connecticut, Maryland, California, Michigan and North Carolina. Petitioner introduced no evidence whatsoever as to any licensing difficulties in the 45 other jurisdictions in which Virginia Surety was licensed to conduct its business. Petitioner also made no claim of any fraud or damage relating to Virginia Surety's bond portfolio, which had an agreed value of approximately $1.3 million. Nevertheless, Petitioner sought, because of "difficulties" with respect to five out of Virginia Surety's 50 licenses, to be relieved entirely of its obligation to pay the $770,000 unpaid balance on its contractual obligation and to collect additional damages.

The non-disclosure of material facts of which Petitioner complained relates to:

a. A tri-annual examination report into the condition of Virginia Surety by the National Association of Insurance Commissioners ("NAIC");

b. Understandings reached with the state insurance departments of California and Michigan under which Virginia Surety agreed not to transact new or renewal business in those states without prior approval of those departments; and

c. The renewal of Virginia Surety's license in North Carolina conditioned on the prior approval of the state Insurance Commissioner for the writing of new business.

The Tri-Annual Examination

The NAIC Report, dated October 1969, indicated that as of December 31, 1968, the capital of Virginia Surety was "impaired to the extent of $2,942.04." The report, however, also made clear that on September 17, 1969, Occidental Fire had made a $400,000 "voluntary contribution to the surplus of the company."

The capital impairment occurred when the NAIC examiners, eight months after the end of the period for which they were examining, increased Virginia Surety's loss reserves and loss adjustment expense reserves. As one of Associates' expert witnesses, former California Insurance Commissioner Richards D. Barger, testified, the reserves for claims established by a casualty company are "a guesstimate, hopefully a correct one" made by the company as to its potential future liability. (Tr. II at 838). The examiners, in the words of Mr. Barger, have "20-20 hindsight" in reviewing actual claims experience against the reserves and thus "perhaps have the advantage over the person who made the decision at the time when the figure was a piece of paper." (Tr. II at 871). Former Commissioner Barger was careful to point out that such an adjustment "doesn't denote any dishonesty or venality on the part of management." (*Id.*)

Associates nevertheless alleged that the NAIC Report caused the States of Connecticut and Maryland to revoke Virginia Surety's licenses (Amended Ans. and Counterclaim at 7, R. at 275). Virginia Surety did in fact lose its license in Connecticut after the sale to Associates. Connecticut's revocation of Virginia Surety's license triggered action by the State of Maryland, which revoked Virginia Surety's license in the latter part of February, 1970. However, that revocation was converted to a suspension almost immediately thereafter, in early March, 1970. (Tr. II at 934-35).

Patrick Ryan, Associates' President, admitted that he was informed by Occidental's management during negotiations for the sale of Virginia Surety of the company's difficulties in Connecticut. They "warned me, advised me, that Connecticut was very difficult to get along with, that they, to quote, nit-picked companies. . . ." (Tr. II at 964). He was told on more than three different occasions: "In all likelihood, you," meaning Virginia Surety, "will lose the Connecticut license." (Tr. II at 533, 218). Ryan replied to these warnings by words to the effect that "the Connecticut license was not that important to him because his business activity wasn't heavy in Connecticut." (Tr. II at 308).

The action of Maryland, on the other hand, was wholly unanticipated, and a "surprise" not only to Associates, but to Occidental as well. (Tr. II at 200). As former New York State Commissioner Bohlinger testified, there could have been no reason to "believe that a state would normally, the impairment having been corrected, just revoke a license out of hand based on that report." (Tr. II at 1261). Indeed, as Mr. Bohlinger testified, the fact that a capital impairment had occurred would *not* necessarily make it "very difficult" for a company to obtain even a new license. (Tr. II at 1276).

The California and Michigan Agreements

In preparation for the sale of Virginia Surety as a "shell" corporation, Occidental agreed with the insurance departments of California and Michigan that Virginia Surety would not transact new or renewal business in those states without prior approval of the respective state insurance commissioners. These agreements were required in order to obtain approval for the transfer of Virginia Surety's "book" of insurance business to another subsidiary of Occidental. This transfer was contemplated and fully understood by the parties. The agreements to obtain prior approval before the new owners of Virginia Surety could write insurance reflect customary regulatory concerns. "[A]s is customary, states are always very concerned about who

the buyers of the company are going to be and they will take various tacks to have an opportunity to approve the buyers." (Tr. II at 258).

Ryan (Tr. II at 422-23, 1096) admitted he was advised by Occidental's management, and that he otherwise knew, that it was "important to go quickly and introduce" himself to the state insurance commissioners in the states where Virginia Surety was licensed. (Tr. II at 1092-93). As Mr. Rutherford, one of Associates' expert witnesses, testified, many commissioners reserve the right to pass upon a new owner before that new owner is given an unrestricted right to do business in that state. (Tr. II at 698, 700). "Certainly" it is "important," Mr. Rutherford believed, for a new owner to establish a relationship with the insurance commissioner. (Tr. II at 695).

Associates, however, did not proceed quickly to contact the state insurance departments after the acquisition. As Ryan himself admitted, he did not contact the Michigan Department until February 1970, because he "was very busy." (Tr. II at 1083). Within three or four months thereafter, Virginia Surety was permitted to write credit life health insurance in Michigan. (Tr. II at 1084). Similarly, in March or April, Virginia Surety received its license to write such business in California. (Tr. II at 1086).

The North Carolina Condition

The Commissioner of Insurance of North Carolina became aware in June 1969, just prior to the annual renewal date of Virginia Surety's license, that the company might be sold. Accordingly, he forwarded Virginia Surety's renewal license under a letter making it clear that the renewal license was not to be construed as authority for Virginia Surety to continue in the insurance business in North Carolina after the sale.

Virginia Surety's license in North Carolina has never been revoked or suspended, and it has been renewed annually since the acquisition by Associates. It is "precisely" in the same condition as when Virginia Surety was owned by Occidental. (Tr. II at 1223). Virginia Surety cannot, however, write credit, health and accident insurance in North Carolina because additional

capital is required before a company can "write additional insurance." That fact was not in any way related to the tri-annual examination report. (Tr. II at 1224).

The Evidence of Damages

At the first trial, Petitioner did not introduce any evidence of damages causally related to Occidental's alleged fraud. Instead, Associates relied exclusively on appraisal testimony of an expert witness as to the "fair market value" of Virginia Surety at the time of sale. That testimony, admitted over Occidental's objections, valued Virginia Surety at $1,500,000.

During the second trial, appraisal testimony of another expert witness for Petitioner was admitted into evidence. That witness valued Virginia Surety as of the date of sale at $1,466,000. On cross-examination, however, the witness made clear that this valuation represented his own appraisal of Virginia Surety's worth, without regard to the value placed on Virginia Surety by the parties. The witness admitted that, based on the contract price, his appraisal of the damages causally related to Occidental's alleged fraud, amounted to only $200,000. (Tr. II at 815).

At the second trial, Associates also offered other proof of damages as an alternative to expert appraisal testimony. That evidence showed that the licensing difficulties allegedly caused by Occidental's fraud caused Associates to incur not more than $245,000 in expenses and loss of profits. The major item related to a loss of profits amounting to $170,000, because of fees or commissions paid to other insurance companies. These companies wrote business produced by Associates in Michigan and Maryland and then ceded that insurance to Virginia Surety —a practice known in the insurance industry as "fronting." (Tr. II at 1017, 1020). As Associates' own expert witness, former California Commissioner Barger, testified, "fronting" is "illegal" in most states. (Tr. II at 858).

The Decision of the Court Below

Upon appeal, the court below held that the trial court did not abuse its discretion in setting aside the jury verdict in the

first trial. It also ruled that Petitioner had waived any right of rescission it may have had by reason of its continued possession of Virginia Surety since the date of sale, that Petitioner could not obtain the same remedy of rescission under the contract voiding provisions of Section 29(b) of the Exchange Act, and that the trial court properly instructed the jury on the issue of damages in the second trial. The court, however, modified the judgment of the trial court by awarding Associates interest on its counterclaim from the date of sale. The effect of that modification was to substantially cancel the interest awarded by the trial court on Occidental's breach of contract judgment.

REASONS FOR DENYING THE WRIT

I.

The Court Below Properly Held That Section 29(b) of the Exchange Act Does Not Permit Petitioner, Having Retained Virginia Surety and Having Been Fully Compensated for Damages Causally Related to Occidental's Violation, to Repudiate Its Contractual Obligation.

Associates asserts that Section 29(b) of the Exchange Act renders "void" all contracts "made in violation of" Rule 10b-5 and that, regardless of Associates "actual damages," it absolutely bars Occidental's enforcement of the contract for the sale of Virginia Surety. The court below concluded, however, that Section 29(b) does not have the "devastating meaning" urged by Associates. (Pet. App. at 16a). In reaching this conclusion the court below relied upon this Court's decisions in *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) and *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38 (1941).

In *Mills*, this Court said that Section 29(b) "does not compel the conclusion that the contract is a nullity, creating no enforceable rights. . . ." (*Id.* at 387). This Court strongly endorsed as "eminently sensible" the holdings of lower courts which, like the holding of the court below, concluded that Section 29(b) "is more properly viewed as an adjunct to the other remedies pro-

vided by the Securities Exchange Act of 1934, and that it should be read as complementing those remedies available to injured parties and not as being antagonistic." (Pet. App. at 17a).

These lower court holdings uniformly reject Associates' contention that Section 29(b) automatically makes a contract unenforceable irrespective of equitable considerations. A contract subject to Section 29(b) "cannot possibly be considered absolute and totally void. It is a contract 'voidable' at the option of the innocent party . . . having the right of recision [sic]." *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783, 792 (8th Cir. 1967). The innocent party's remedies under Section 29(b) are enforceable in "a proceeding in equity." *Spoon* v. *Walston & Co.*, 345 F. Supp. 518 (E.D. Mich. 1972).

Thus, in *Royal Air Properties, Inc.* v. *Smith*, 312 F.2d 210 (1962), the Court of Appeals for the Ninth Circuit made clear that Section 29(b) does not furnish immunity from the normal defenses of waiver and estoppel so as to permit a buyer of securities to retain the benefits of the seller's performance while repudiating his own performance. The court referred to its earlier decision in *Straley* v. *Universal Uranium & Milling Corp.*, 289 F.2d 370 (9th Cir. 1961), where it said with respect to an action under Section 12(1) of the Securities Act of 1933, 15 U.S.C. § 771(1) (1970), that estoppel and waiver

> ". . . are available to one against whom an action at law is brought on a contract declared voidable by common law. On principle, we see no reason why such defenses would not likewise be available to one against whom an action is brought on a contract declared voidable by judicial construction of a statute. There is nothing in the language of Section 771 or its legislative history to indicate that Congress intended to create a right enforceable in law or in equity not subject to defenses available at law or in equity to an action based on a voidable contract. The silence of Congress cannot be construed as an intention to make such defenses unavailable." 289 F.2d at 373-374.

The court concluded that this reasoning was "also applicable to an action brought under Sections 10(b) and 29(b) of the Securities Exchange Act of 1934." (*Id.*).

This Court in *Mills* emphasized that the interests of the victim are sufficiently protected by giving him the right to rescind. 396 U.S. at 388. The court below also recognized that Associates had a right to rescind. It found, however, that Associates had abandoned that right because it failed to act with "reasonable dispatch." (Pet. App. at 21a). The court below pointed out that

> "Associates was clearly aware of the problems relating to Virginia Surety by at least the early part of 1970. By the summer of 1970, Associates had held meetings with Occidental concerning these problems, and thus was chargeable with notice of misstatements and concealments of Occidental. Yet the first mention of rescission took place in Associates' motion to amend its answer and counterclaim in November of 1972." (Pet. App. at 21a-22a).

Accordingly, the court held that "the passage of two and one-half years [cannot] be deemed to show reasonable diligence." (Pet. App. at 21a-22a). The court also recognized that "the delay in this case is particularly onerous since Associates continued to run Virginia Surety as it saw fit." (*Id.*). The court's holding was consistent with its prior holdings on the same issues in *John Hopkins University* v. *Hutton*, 488 F.2d 912 4th Cir. (1973), and *Baumel* v. *Rosen*, 412 F.2d 571, 575 (1969) *cert. denied* 396 U.S. 1037 (1970).*

Associates, having elected to retain its ownership of Virginia Surety and all the benefits of that ownership for over four

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*Associates, recognizing that its claim for rescission would be barred by *Baumel*, argues that Section 12(2) gives it an *absolute* "statutory (not equitable) right of rescission." But *Straley* involved an action under Section 12(1), which affords remedies identical to those provided by Section 12(2), and makes clear that there is no such "absolute" right.

years, must be held as a matter of law to have waived any right which it might otherwise have had to rescind its purchase of Virginia Surety. And the court below so held. Absent rescission Associates cannot bar enforcement of its promise to pay for Virginia Surety. Any contrary result would be both inequitable and in conflict with this Court's command that "the courts are to be guided by the overriding general policy, as Mr. Justice Holmes put it, 'of preventing people from getting other people's property for nothing when they purport to be buying it.'" *Kelly* v. *Kosuga*, 358 U.S. 516, 520-21 (1959).

The court below also found a direct analogy between the case at bar and this Court's decision in *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 312 U.S. 38 (1941). This Court there made clear that non-enforcement of a contract does not automatically follow from a violation of the federal securities laws, stating:

> "The rule that contracts in contravention of public policy are not enforceable . . . 'should be applied with caution and only in cases plainly within the reasons on which that doctrine rests.'" 312 U.S. at 44.

Associates' attempt to bar enforcement of its contract with Occidental underscores the need for the "caution" expressed by this Court in *Frost* and demonstrates the wisdom of the court below in seeking the adoption of sensible remedies which will produce equitable results. To bar enforcement of Occidental's contract solely because of a violation of the federal securities laws could create a remedy measured by the amount of credit extended rather than by the extent of damages suffered as a result of the violation. As one commentator has noted with respect to the "illogic" of such a remedy:

> "[A] defense allowed primarily to enforce the statutory duties of the plaintiff need not embrace a sanction which exceeds the gravity of the harm it is seeking to deter. The illogic of so sweeping a remedy is particularly acute when

> the defense is posed in a suit for the agreed price of shares previously transferred. Its measurement then depends solely on the amount of credit extended, a factor wholly unrelated to the asserted illegality." Note, *Enforceability of Underwriting Contracts Illegal Under the Securities Act of 1933*, 73 HARV. L. REV. 1345, 1354 (1960).

In its Petition, Associates argues that the court below misunderstood *Frost* because that case arose under the Securities Act of 1933 which does not have Section 29(b) among its available remedies. But as the court below recognized, Section 29(b) merely incorporates the common law principles recognized in *Frost*. This Court's emphasis in that case of the duty of the courts to carry out the legislative mandate by choosing among available remedies to produce a sensible and equitable result is as applicable to actions under the Exchange Act as it is to actions under the Securities Act of 1933.

Associates' attempts to distinguish *Mills* by limiting that decision "to the unusual facts there presented." (Pet. at 14). But as suggested by *Mills*, Associates' interests are well and sensibly protected by the award of damages which fully compensated it for all injuries flowing from the violation. Just as in *Mills*, there is no basis for depriving the courts in this case of the flexibility to fashion the equitable remedies that effectuate the purposes of the federal securities laws.

Associates argues that a conflict exists among the Circuits because some courts have voided transactions and held them unenforceable under Section 29(b). But no case relied upon by Associates involved a buyer who adopted and retained the benefits of a transaction while seeking to bar enforcement of its obligation to pay.

Contrary to Associates' assertion, *Sundstrand Corp.* v. *Standard Kollsman Industries, Inc.*, 488 F.2d 807 (7th Cir. 1973) is not a case "almost identical" to this one. (Pet. at 11). In *Sundstrand*, unlike Associates, the buyer promptly "sought as relief a rescission of the transfer." 488 F.2d at 809. It did not seek, as Petitioner seeks here, to keep the securities while

repudiating its contractual obligations to pay for them. Similarly, in *Goldman* v. *Bank Commonwealth*, 467 F.2d 439 (6th Cir. 1972) and *Serzysko* v. *Chase Manhattan Bank*, 290 F. Supp. 74 (S.D.N.Y. 1968), also relied upon by Petitioner, the buyers did not seek to retain securities purchased. Absent such prompt rescission the courts have not permitted voiding of the contract. As the court in *Goldman* pointed out "The courts have not particularly favored a person who seeks to avoid payment of his debts by asserting the defense of illegality." 467 F.2d at 447. Neither should this Court favor Associates' efforts to invoke Section 29(b) to avoid payment of its debt. As this Court noted in *Mills*, "to regard the contract as void where he has not invoked that right [of rescission] would only create the possibility of hardships to him or others without necessarily advancing the statutory policy of disclosure." 396 U.S. at 388.*

Associates apparently recognizes that the result it seeks of treating the contract as a nullity under Section 29(b) would hardly be equitable. It attempts to ameliorate that harsh result by suggesting that perhaps the court could award Occidental some additional compensation. But, as the court below noted:

> ". . . [T]his case presents no basis for use of a quasi-contract theory of recovery. Associates had the option to affirm the contract and sue for damages, or it could elect to rescind." (Pet. App. at 20a).

Associates cannot keep Virginia Surety while repudiating its contractual obligation to pay for it. That, however, is precisely the harsh and inequitable result they seek from this Court.

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*Associates relies on the dictum in *Mills* where the Court stated that "the guilty party is precluded from enforcing the contract against an unwilling innocent party. . . ." 396 U.S. at 387. After having accepted and retained all the benefits of Occidental's performance, with knowledge of Occidental's fraud, for over four years, Associates can hardly be characterized as an "unwilling innocent party" to the contract.

II.

The Court of Appeals Properly Refused to Interfere With the Trial Court's Exercise of Discretion in Setting Aside the Verdict of the First Trial.

A. *The Court of Appeals, in Reviewing the Trial Court's Exercise of Discretion, Applied the Same Standard Adopted by this Court and Other Courts of Appeals.*

The court below held that its review of the trial court's decision to set aside the verdict in the first trial and to grant a new trial was "limited to ascertaining whether the decision amounts to an abuse of discretion." (Pet. App. at 12a). The court below, after examining the record with respect to the evidence of damages, could not conclude that the trial court abused its discretion in finding that the first verdict of $797,000 was excessive. (*Id.*).

Petitioner urges that this Court grant certiorari on the ground that the court below adopted an improper standard and procedure for review of the trial court decision. In fact, the standard applied by the court below, that its function was limited to a determination of whether the trial court had abused its discretion, is precisely the well-established standard followed by this Court and other Courts of Appeals.

There can be no question that the grant of a new trial by a federal trial judge does not contravene the Seventh Amendment. As Judge Parker in *Aetna Casualty & Surety Co.* v. *Yeatts*, 122 F.2d 350 (4th Cir. 1941), said:

> "The exercise of this power is not in derogation of the right of trial by jury but is one of the historic safeguards of that right." 122 F.2d at 353.

This Court has itself implicitly recognized the constitutionality of this power of the trial court as applied to excessive damages in

Montgomery Ward & Co. v. *Duncan*, 311 U.S. 243 (1940), where it held that

> "[T]he motion for a new trial may invoke the discretion of the court in so far as it is bottomed on the claim that the verdict is against the weight of evidence, that the damages are excessive, or that, for other reasons, the trial was not fair to the party moving. . . ." 311 U. S. at 251.

This Court has also made clear that the decision of a trial judge upon a motion for a new trial is not subject to review either by this Court or the circuit courts, absent an abuse of discretion. Thus in *United States* v. *Socony Vacuum Oil Company, Inc.*, 310 U.S. 150, *rehearing denied* 310 U.S. 658 (1940), this Court, having found no abuse of discretion by the trial court, refused to interfere with the discretion of the trial court in denying new trials to certain defendants, stating:

> ". . . [T]his case falls within the well established rule that neither this Court nor the Circuit Court of Appeals will thereafter review the action of a federal trial court in granting or denying a motion for a new trial for error of fact, since such action is a matter within the discretion of the trial court." 310 U.S. at 247.

See, also, Fairmont Glass Works v. *Cub Fork Coal Company*, 287 U.S. 474, 481 (1933) where Judge Brandeis held that

> "The rule [that this court will not review the action of a federal trial court in granting or denying a motion for a new trial] . . . precludes likewise a review of such action by a Circuit Court of Appeals."

This Court's opinions in *Socony Vacuum Oil* and *Fairmont Glass Works* make no distinction between the grant or denial of a new trial in describing the limited role of appellate courts in reviewing the trial court's decision. Nevertheless, Petitioner suggests that a special standard for appellate review

should be applied in cases where a new trial is ordered because the size of the jury verdict is contrary to the weight of evidence. (Pet. at 18). In fact, however, the decisions of the several Courts of Appeals are uniform in holding that, in these as in other cases, the appellate court may reverse the trial court's grant of a new trial only where it is clear that the trial court abused its discretion. *See, e.g., Holmes* v. *Wack*, 464 F.2d 86 (10th Cir., 1972); *Mooney* v. *Henderson Portion Pack Co., Inc.*, 339 F.2d 64 (6th Cir. 1964). In *Holmes* v. *Wack*, the Court of Appeals for the Tenth Circuit refused to interfere with the trial court's exercise of discretion in setting aside an excessive jury verdict, stating:

> "It is clear . . . that a federal trial judge has a broad discretion in the area of granting or refusing to grant a motion for new trial, and the decision of a district court judge will not be reversed absent a gross abuse of discretion." 464 F.2d at 89

Indeed, Petitioner's attempt to find a conflict between the standard for review applied by the court below and the standard applied by the courts in other circuits is sharply contradicted by the very cases cited by Petitioner in support of the purported conflict. (Pet. at 19). For example, in *Manning* v. *Altec, Inc.*, 488 F.2d 127 (6th Cir. 1973), the court plainly stated that "the action of a trial court in granting a new trial on the ground that a verdict is excessive is subject to review only for abuse of discretion. . . ." 488 F.2d at 131.

Similarly, in *Taylor* v. *Washington Terminal Co.*, 409 F.2d 145 (D.C. Cir. 1969), *cert. denied* 396 U.S. 835 (1969), the court stated that the trial court's "exercise of discretion in granting the motion is reviewable only for abuse." 409 F.2d at 149. And in *Lind* v. *Schenley Industries, Inc.*, 278 F.2d 79 (3d Cir. 1960), *cert. denied* 364 U.S. 835 (1960) the court made clear that reversal is possible only "if an appellate court is shown special or unusual circumstances which clearly indicate an abuse of discretion. . . ." 278 F.2d at 88. The court emphasized that

"appellate courts rarely find that the trial court abused its discretion." (*Id.*)

It is quite obvious that Petitioner seeks certiorari from this Court, not to review the standard applied by the court below, but to impose upon this Court the burden of scrutinizing the record before the trial court in the hope that this Court might see fit to substitute its evaluation of the evidence for those of both the trial court and the Court of Appeals for the Fourth Circuit. The decisions of this Court make clear that such a review is not proper and, even if this Court should evaluate the record, the record would clearly support the decision of the court below.

B. *The Trial Court Did Not Abuse Its Discretion in Concluding That the First Jury's Award of $797,000 "Was So Grossly Contrary to the Weight of the Evidence as to Be Shocking to the Conscience of the Court."*

Contrary to Petitioner's contention, this is not a case in which the trial judge deprived a litigant of "a reasonable and proper jury verdict on the question of the amount of his damages. . . ." (Pet. at 25). It is patently obvious that in the first trial Associates failed to introduce competent evidence of damages causally related to Occidental's violation and that the first jury simply failed to follow the trial judge's instruction on damages. As a consequence, the amount awarded as damages, $797,000, bore no rational relationship to any evidence of actual damages suffered by Petitioner as a result of the violation of Rule 10b-5 found by the jury.

1. A plaintiff in a Rule 10b-5 action is limited to recovery of actual damages proximately caused by the Rule 10b-5 violation.

Section 28(a) of the Exchange Act, 15 U.S.C. § 78bb(a) (1970), explicitly limits recovery of damages for any Exchange Act violation, including Rule 10b-5, to the losses which plaintiff has actually sustained as the proximate result of the violation.

Section 28(a) makes unmistakably clear that no person is entitled to recover "in excess of" his "actual damages," and such "actual damages" must be "on account of the act complained of." Failure to show "actual damages" is "a fatal defect in the cause of action based on the Securities Exchange Act of 1934. . . ." *Estate Counseling Service Inc.*, v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 303 F.2d 527, 533 (10th Cir. 1962).

This means, in short, that a plaintiff in a Rule 10b-5 action is limited to those "actual damages" proximately caused by the Rule 10b-5 violation. Such result is consistent with the well-settled principle that a private right of action under Rule 10b-5 "lies in tort and not on contractual grounds." *Myzel* v. *Fields*, 386 F.2d 718, 744 (8th Cir. 1967), *cert. denied* 390 U.S. 951 (1968). To recover under traditional concepts of damages in fraud actions "it must appear, not only that injury has been suffered, but that the fraud complained of was the proximate cause of the injury." *Boatman's Nat'l Co.* v. *M. W. Elkins & Co., Inc.*, 63 F.2d 214, 216 (8th Cir. 1933).

The requirement is no different in Rule 10b-5 actions. In *Myzel* v. *Fields, supra*, the court specifically affirmed that in Rule 10b-5 actions, as in common law fraud actions, "to be recoverable the damages must be proximately caused by the defendants." 336 F.2d at 744.

In *Baumel* v. *Rosen*, 412 F.2d 571, 576 (1969), the Court of Appeals for the Fourth Circuit specifically held that "while a defrauding party is not to be excused, neither is he to be punished," and that in Rule 10b-5 actions "[a] fair attempt to compensate for wrongs is the aim." Similarly, in *Green* v. *Wolf Corp.*, 406 F.2d 291, 303 (2d Cir. 1968), *cert. denied* 395 U.S. 977 (1969), the Court of Appeals for the Second Circuit said that it did "not believe that Congress intended the Securities and Exchange Act [sic] to be used as a vehicle for recovery of judgments that could often be grossly disproportionate to the harm done." That is why, said the Second Circuit, Section 28(a) of the Exchange Act specifically limits a plaintiff's recovery in Rule 10b-5 actions to "actual damages."

2. The first jury failed to follow the trial court's specific instruction that Petitioner's recovery was to be limited to those actual damages proximately caused by Occidental's Rule 10b-5 violations.

Petitioner, at page 22 of its Petition, purports to set forth the trial court's charge to the jury on damages during the first trial. Petitioner, however, fails to mention that the very first sentence of the charge stated:

> "The party injured by any violation of these statutes or rules may recover *any loss proximately resulting therefrom.*" (Tr. I, 11/17/72 at 141). (emphasis added).

Before reaching its verdict, the jury returned to the courtroom for a clarifying instruction. The trial judge again reiterated to the jury that

> "The party injured by any violation of the statute or rule may recover *any loss proximately resulting therefrom.*" (Tr. I, 11/17/72 at 150). (emphasis added).

The first trial jury was not, as Petitioner asserts, "*required* by the instructions of the court to return a verdict for exactly the amount awarded." (Pet. at 22). To the contrary, the jury could have returned a damage award for that amount only by failing to follow the court's instructions. That fact, standing alone, fully authorized the court to grant a new trial. For it is beyond reasonable dispute that the figure, $797,000, bore no relationship to "actual damages" proximately caused by Occidental's alleged Rule 10b-5 violations.

Indeed, there is no guesswork whatsoever as to how the jury reached its verdict. It simply determined that it would "cancel out" the trial court's direction of a verdict in Occidental's favor of $770,000, representing the unpaid balance due on the contract price, and award an additional $27,000 to Petitioner as "actual damages." This is not a matter of speculation because, just before returning its verdict, the jury returned to the courtroom to ask the following question of the trial judge:

> "Foreman: Your Honor, we have a question as a matter of clarification about the stated question on this white

> sheet here, reading 'what amount of damages, if any, is defendant entitled to recover on its counterclaim?' And the question we have is is [sic] the figure that we put here, if we put one here, will that be a figure independent of the $700,000 [sic $770,000] which Mr. Ryan owes according to the terms of the contract? *Or would this figure be an amount that would not tend to cancel out this claim?"* (Tr. I, 11/17/72 at 148-149). (emphasis added).

But the jury was not entitled to "cancel out" the directed verdict and thereby relieve Petitioner of its contractual obligation. It was charged with the duty of determining from the evidence what Petitioner's "actual damages" were proximately resulting from Occidental's alleged Rule 10b-5 violations. Petitioner's obligation to pay the balance due on the contract, $770,000, was not a measure of Petitioner's "actual damages." By hinging its award on that figure, the jury reached a verdict that was legally improper and grossly disproportionate to the "actual damages" which Petitioner suffered, as the trial court correctly discerned.

Petitioner attempts to argue that the $797,000 damages awarded in the first trial relate to its "actual damages" by asserting that it "agreed to a purchase price far in excess of the value of the stock, in return for an arrangement (the reinsurance agreement) under which a major portion of the price could be satisfied by a transfer of business to the seller, rather than with cash." (Pet. at 24). On this basis, Petitioner contends that the trial court's directed verdict on the breach of contract action forced the transaction into a straight cash deal at an excessive price.

Petitioner's argument assumes that the reinsurance arrangement whereby the $770,000 unpaid portion of the purchase price could be satisfied by a transfer of business rather than with cash would have cost it nothing. Such an assumption defies common sense! If Petitioner could have paid the unpaid balance of the purchase price, with no cost to it, why would it not fulfill its contractual obligations and then recover, in cash, the damages allegedly caused by Occidental's fraud? Instead

it chose, as no rational businessman would, to repudiate that allegedly "no cost agreement" and to expose itself to substantial liability for breach of contract.

Petitioner did not merely agree to pay $770,000 to Occidental through reinsurance agreements. It also specifically guaranteed that if, for any reason, it failed to perform under the reinsurance agreement, it would pay Occidental the $770,000 in cash. It is beyond dispute that Petitioner failed to make those payments in breach of its contract with Occidental.

3. Moreover, Petitioner failed to introduce any evidence of actual damage in the first trial.

The record of the first trial is barren of any evidence of "actual damages" despite the fact that Petitioner clearly carried the burden on that issue. Petitioner never sought to establish the extent to which, if any, the alleged wrongful acts of Occidental caused Virginia Surety to be worth less than the agreed-upon price for Virginia Surety. Indeed, Petitioner contends that the agreed-upon price for Virginia Surety is an irrelevancy and no measure whatsoever of the "fair market value" of Virginia Surety, defect-free, at the time of sale.

The "fair market value" for any property, however, is that amount which a willing buyer will pay a willing seller for the property in an arms-length transaction. *Corbin on Contracts* § 127 (one vol. ed. 1952). Associates and Occidental made their own contracts and by contract fixed the "fair market value" for Virginia Surety in the amount of $2,297,000.

Petitioner is not entitled, as it seeks, to disregard its own contract valuation in establishing how much less Virginia Surety is worth on account of the alleged defects. To do so is to renegotiate the contract price of Virginia Surety at some hypothetical "fair market valuation," irrespective of the damage caused by Occidental's alleged violations. That is precisely what Petitioner's expert witness did when he placed the fair market value of Virginia Surety at $1,500,000. Petitioner's figure of $1,500,000 is, therefore legally meaningless as evidence of the "actual damages" suffered. It is not evidence of what Petitioner would have been willing to pay in the light of its own needs and circumstances for Virginia Surety with defects. It is an opinion

wholly unrelated to the needs and circumstances of Petitioner which, in fact, agreed to pay $2,297,000 for a defect-free Virginia Surety.

Petitioner has never alleged, nor is there any evidence to show, that Occidental falsely represented the fair market value of Virginia Surety. What Petitioner is really contending is that it paid too much for Virginia Surety, entirely aside from the alleged misrepresentations, and should, therefore, be relieved of its contractual obligations. The court below properly refused to permit such a result, stating:

> "Associates' real quibble is that it paid an allegedly inflated price for a defect-free Virginia Surety. That may show poor business acumen on Associates' part, but utterly fails to show any windfall profits." (Pet. App. at 15a).

4. The trial court properly found the jury's $797,000 damage award shocking to its conscience because, under any rational hypothesis, Petitioner's actual damages could not have approximated that figure.

It is apparent from the record of the first trial that Petitioner's "actual damages" could not have remotely approached $797,000. If Petitioner had obtained everything it contends that it was entitled to, it would have received a "shell" corporation with no liabilities but with capital and surplus, represented by bonds on deposits with state insurance regulatory agencies, and licenses to conduct an insurance business in 50 jurisdictions. The parties specified in the October 22 agreements of sale that the value of the capital and surplus was $1,326,717.70. Thus, even if all 50 of the licenses conveyed had been worthless, or not even conveyed at all, Petitioner still would have received assets valued at $1,326,717.70.

Thus, the 50 licenses were conveyed at a contract price valuation of $970,282.30.* Associates contends that five of the

*The figure of $970,282.30 represents the difference between the contract price of $2,297,000 and $1,326,717.70 for capital stock and surplus. That figure of $970,282.30 is necessarily the value which the parties placed upon the corporate charter and 50 licenses, since, apart from the capital and surplus, nothing else was conveyed.

50 licenses were defective to a greater or lesser extent, *i.e.*, the licenses for California, Michigan, Connecticut, Maryland and North Carolina. There is no contention that the licenses in the other 45 jurisdictions contained any defects whatsoever.

Under any hypothesis, it is rationally indefensible to suggest that the five allegedly defective licenses should be assigned a valuation of $797,000, or $160,000 per license, while the remaining 45 non-defective licenses only deserve a total valuation of $173,000, or $3,850 per license. Nothing in the record supports such an absurd disparity. Accordingly, the trial court was fully warranted in setting aside the first jury award of $797,000 as excessive and contrary to the clear weight of the evidence. The court below was equally justified in refusing to interfere with the trial court's exercise of discretion.

CONCLUSION

For the reasons set forth above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

RICHARD M. PHILLIPS
ALAN J. BERKELEY
GREGORY T. DIAZ
2000 L Street, N. W.
Washington, D. C. 20036
Counsel for Respondent

Of Counsel:

HILL, CHRISTOPHER AND PHILLIPS, P. C.
Washington, D. C. 20036

GEORGE R. RAGSDALE
Raleigh, North Carolina 27602

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